First State Investments
首域投資

First State Asian Quality Bond Fund

Monthly Review and Outlook

January 2020

- The Fund invests primarily in debt securities of governments and corporate issuers organised, headquartered or having their primary business operations in Asia.
- The Fund's investments may be concentrated in a single, small number of countries or specific region which may have higher volatility or greater loss of capital than more diversified portfolios.
- The Fund invests in emerging markets which may have increased risks than developed markets including liquidity risk, currency risk/control, political and economic uncertainties, high degree of volatility, settlement risk and custody risk.
- The Fund invests in sovereign debt securities which are exposed to political, social and economic risks.
- The Fund invests in debts or fixed income securities which may be subject to credit, interest rate, currency and credit rating reliability risks which would negatively affect its value. Investment grade securities may be subject to risk of being downgraded and the value of the Fund may be adversely affected. The Fund may invest in below investment grade, unrated debt securities which exposes to greater volatility risk, default risk and price changes due to change in the issuer's creditworthiness.
- The Fund may use FDIs for hedging and efficient portfolio management purposes, which may subject the Fund to additional liquidity, valuation, counterparty and over the counter transaction risks.
- For certain share classes, the Fund may at its discretion pay dividend out of capital or pay fees and expenses out of capital to increase distributable income and effectively a distribution out of capital. This amounts to a return or withdrawal of your original investment or from any capital gains attributable to that, and may result in an immediate decrease of NAV per share.
- It is possible that a part or entire value of your investment could be lost. You should not base your investment decision solely on this document. Please read the offering document including risk factors for details.

Market Review

The month started quite encouragingly, with spreads holding quite close to their late 2019 tights early in January. Economic data was reasonably encouraging and US and Chinese officials formally signed the 'phase one' trade deal that had been agreed in December.

News of the spread of coronavirus dampened investors' mood in the second half of the month, however, and saw spreads widen quite sharply into month end. With investment grade and high yield spreads narrowing late in 2019, Asian credit valuations left little room for disappointment. They therefore came under pressure as investors suggested the virus outbreak could restrict economic activity levels in China and elsewhere in the Asia Pacific region. By month end, several airlines had suspended services to and from mainland China, which seems likely to affect tourism-related sectors worldwide to some extent. There were various other disruptions to usual economic activity, clouding the outlook for corporate earnings in China and neighboring countries.

Treasury yields were pushed sharply lower as investors priced in a potential slowdown in global growth. In fact, the rally in Treasuries more than offset spread widening and ensured total returns from Asian credit were positive. The JACI Index returned 1.36% over the month. Investment grade issuers outperformed those in the high yield sector as investors reined in their risk appetite. Unsurprisingly, issuers with exposure to Wuhan – various property companies, for example - fared particularly poorly.

Most economic data releases were broadly in line with consensus expectations. The pace of GDP growth was unchanged in the December quarter in both the US and China, for example. In mid-month, Chinese and US officials formally signed the 'phase one' trade deal that was agreed in December. In Europe, the UK completed its withdrawal from the European Union on 31 January as planned. Whilst positive, these developments did not materially affect sentiment as investors focused on coronavirus-related risks.

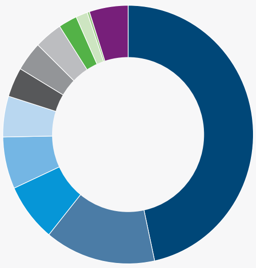
Policy settings were unchanged in most countries, though Bank Negara lowered Malaysian interest rates by a quarter of a percentage point to 2.75%. At just 1.0%, inflation remains under control in Malaysia, enabling policymakers to lower borrowing costs pre-emptively to help support domestic demand.

It was the busiest January on record for new issuance. Of more than USD 45b in total, around USD38b of USD-denominated paper was priced. This was an increase of nearly 50% from January 2019 levels. The spike was partly attributable to the early timing of the Lunar New Year holiday, as some Chinese developers completed issuance prior to the expiry of previously approved quotas from the National Development and Reform Commission. More than half of the total issuance was in the high yield sector; much of it completed before virus-related fears started to dominate attention.

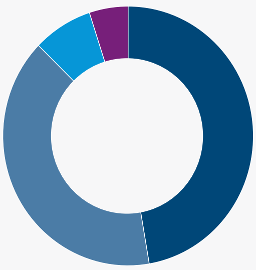
	Cumulative Performance in USD (%) [1]					
	3 mths	YTD	1yr	3yrs	5yrs	Since inception
Class I (USD - Acc)	1.8	1.4	10.6	16.4	20.5	83.8
Benchmark*	2.0	1.5	10.9	17.9	24.5	136.1

	Calendar Year Performance in USD (%) [1]				
	2019	2018	2017	2016	2015
Class I (USD - Acc)	10.9	-1.3	5.6	3.4	0.9
Benchmark*	11.0	0.0	5.5	4.5	2.2

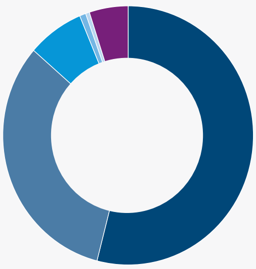
Asset Allocation (%) [1]



Country
- China 46.7
- Hong Kong 14.3
- USA 7.3
- South Korea 6.5
- Singapore 5.1
- Malaysia 3.7
- Indonesia 37
- India 3.6
- Thailand 2.4
- Australia 1.5
- Other 0.2
- Liquidity 5.0



Sector
- Corporates 47.3
- Govt Related 40.0
- Treasury 7.7
- Liquidity 5.0



Credit rating
- BBB 54.0
- A 32.4
- AAA 7.3
- AA 0.7
- BB 0.5
- Liquidity 5.0

Top 10 Issuers (%) [1]

Issuer Name	%
United States Treasury	7.3
China Huarong	4.2
Bank of Communications Co Ltd	3.4
Sinochem Hong Kong (Group) Co Ltd	3.2
Hyundai Motor Co	3.2
United Overseas Bank Ltd	3.0
ICBC Financial Leasing Co Ltd	3.0
Nan Fung International Holdings Ltd	3.0
China National Offshore Oil Corp	2.8
China Overseas Land & Investment Ltd	2.5

Performance Review

The First State Asian Quality Bond Fund returned 1.41% for the month of January on a net of fees basis.

The strong positive return was largely attributed to the strong rally in US treasury, which more than offset the widening in credit spreads. US 10-year Treasury yield was 40bps lower for the month as market priced in significant downside to economic growth following the outbreak of the coronavirus.

On a relative basis, the fund slightly outperformed the index due to our short US interest rate duration positioning.

Portfolio Positioning

While our funds were already defensively positioned heading into 2020, exposure to gaming/resorts names including Genting and Resort World was reduced during the month as we expect the coronavirus outbreak to sharply reduce travel and hence hurt profits of these firms. The previous short US interest rate duration was also changed to a moderate long, as we expect the reported cases of the flu to increase post the Lunar New Year holiday. If the situation is prolonged, global growth is likely to be significantly impacted, potentially exerting further downward pressure on global bond yields.

Q1 2020 Investment Outlook

Writing an outlook for 2020 is turning out to be a lot easier when compared to the same time a year ago, as many of the factors and uncertainties that hampered market sentiments for a big part of 2019 have either changed course or dissipated. A year ago bond investors were in angst as we were still in the midst of a Fed rate hike cycle. The Fed has since cut policy rate three times which felt inconceivable to many even as recent as the middle of last year. The US-China trade war which showed no signs of ending may finally start to ease, as the two economic powers look set to sign on a phase one deal with a potential for a phase two coming around the middle of the New Year. Even the United Kingdom looks likely to now make a breakthrough on Brexit after years of postponement and negotiations, potentially leaving the European Union in an orderly manner on 31 January 2020.[#] The optimism arising from these recent development on a macro level looks set to continue as we start the New Year, further boosted by recent global economic data which point to some stabilisation in growth.

Growth has slowed in the US throughout 2019 but they were not as bad as what market had feared. The slowdown was largely due to weaker fixed investments and exports, even though consumption has held up reasonably well. What is encouraging is the revision of 3rd quarter GDP growth estimate from 1.9% to 2.1% suggesting signs of improvement of late. Durable goods orders were also above expectations in the US while unemployment remained at historical low. Unemployment is now the lowest in 50 years though quality of jobs has been poor, which partly explains why there has been a lack of inflation. This set of decent economic numbers should allow Trump to tick

[1] Source: Lipper & First State Investments, Nav-Nav (USD total return) as at 31 January 2020. Allocation percentage is rounded to the nearest one decimal place and the total allocation percentage may not add up to 100%. Fund inception date: 14 July 2003. Performance is based on First State Asian Quality Bond Fund Class I (USD - Acc) is the non-dividend distributing class of the Fund. * The benchmark displayed is the JP Morgan Asia Credit Investment Grade Index. # Please note that the UK has left the European Union on 31 January 2020.

many of the boxes on his list of deliverables as he heads into election in 2020. We will now likely to hear more of his rhetoric around his wish for a weaker dollar and lower rates in the months ahead. Development around the US election will be one of the key drivers of the market in the months ahead.

In our previous outlook, we questioned the effectiveness of monetary policies in the developed economies and advocated that fiscal stimulus is likely to be the more effective policy tool as we start the new decade. Since then, Japan announced a massive USD 162.5b fiscal stimulus which aim to support economic growth beyond the upcoming Olympics. Indonesia is also likely to boost infrastructure spending in Jokowi's second term in charge. Jokowi has already announced a plan to move the nation's capital from Jakarta to East Kalimantan. While Asian central banks still have room to cut interest rates to support growth, we expect to see more fiscal stimulus albeit in a moderate and targeted manner.

Asian credits' fundamentals have been broadly stable in recent years as many corporates have been deleveraging and improving their balance sheets. While there has been areas of distress mainly in the Chinese Industrial and Indonesia high yield space, they tend to be more idiosyncratic in nature. Hence default rate in Asia will likely remain benign in the 2-2.5% range for 2020. Rising defaults in China has been well documented in the past two years. While defaults in China will remain elevated as we move into the New Year, we do get some comfort that Chinese defaults both onshore and offshore in 2019 did not increase materially from 2018. One key point bond investors should take note of is that with the defaults, there will more credit differentiation amongst Chinese issuers including those issued by State Owned Enterprises (SOEs) and Local Government Financing Vehicles (LGFVs). The recent default by the Tewoo Group and the turmoil around the Peking University Founder Group are timely reminders to investors that credit risks amongst State Owned Enterprise in China is rising with reduced implicit support from the government and that trend is likely to continue.

One of the key reasons behind the strong performance in 2019 was the return of the onshore Chinese investors after being largely absent the year before. Their continued participation will be a great boost for market's technical. On top of that, gross supply for 2020 is expected to moderate following a record year of issuance, providing further support to market prices. The significant increase in new issue allocation to Asian investors is also a positive trend for our credit market.

Following massive spreads tightening last year, which saw JACI IG spreads tighter by 40bps and high yield spreads tightening by 100bps, valuations are now hovering around the 5-year average. We believe JACI IG spreads of around 180bps at the point of writing has more or less reflected its stronger fundamentals and resilient nature as an asset class. The 100bps rally in US treasury also made all in yield less compelling for investors. Hence we would stay advocate staying defensive and await a pullback before increasing our risk exposure.

In summary, macro backdrop has turned more stable for now which bodes well for risky assets including credits. Fundamentals in Asian credit remain sound while demand and supply technical backdrop is highly supportive. Nevertheless, following such stellar performance last year during which we recorded double digit gains in both investment grade and high yield it pays to be more cautious and focus on avoiding potholes. It is also worth noting that in 2019, the spectacular returns in both equity and bond markets were delivered despite a bleak macro outlook. Will 2020 turn out to be a mirror image of the year before? At this stage we would not bet against it.

Important Information

Investment involves risks, past performance is not a guide to future performance. Refer to the offering documents of the respective funds for details, including risk factors. The information contained within this document has been obtained from sources that First State Investments ("FSI") believes to be reliable and accurate at the time of issue but no representation or warranty, expressed or implied, is made as to the fairness, accuracy or completeness of the information. Neither FSI, nor any of its associates, nor any director, officer or employee accepts any liability whatsoever for any loss arising directly or indirectly from any use of this. It does not constitute investment advice and should not be used as the basis of any investment decision, nor should it be treated as a recommendation for any investment. The information in this document may not be edited and/or reproduced in whole or in part without the prior consent of FSI.

This document is issued by First State Investments (Hong Kong) Limited and has not been reviewed by the Securities and Futures Commission in Hong Kong. First State Investments is a business name of First State Investments (Hong Kong) Limited. The First State Investments logo is a trademark of the Commonwealth Bank of Australia or an affiliate thereof and is used by FSI under licence.

Reference to specific securities (if any) is included for the purpose of illustration only and should not be construed as a recommendation to buy or sell the same. All securities mentioned herein may or may not form part of the holdings of First State Investments' portfolios at a certain point in time, and the holdings may change over time.

First State Investments (Hong Kong) Limited is part of the investment management business of First Sentier Investors, which is ultimately owned by Mitsubishi UFJ Financial Group, Inc. ("MUFG"), a global financial group. First Sentier Investors includes a number of entities in different jurisdictions, operating in Australia as First Sentier Investors and as FSI elsewhere.

MUFG and its subsidiaries are not responsible for any statement or information contained in this document. Neither MUFG nor any of its subsidiaries guarantee the performance of any investment or entity referred to in this document or the repayment of capital. Any investments referred to are not deposits or other liabilities of MUFG or its subsidiaries, and are subject to investment risk, including loss of income and capital invested.